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Financial Development and Inclusive Growth: Impact of Government Intervention in Prioritised Credit

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Abstract: Equitable growth is indeed vital for inclusive growth which in turn can lead to sustainable growth. Access to finance by the poor is a prerequisite for poverty reduction and sustainable economic development. This study has established that there is a strong need to strengthen policy approach for financing the priority sector in India as it has had a positive impact on inclusive growth. In view of the strong relationship between priority sector lending and inclusive growth, it is imperative on the policy makers in general and the governments in particular to make efforts to induce the banks and financial institutions in increasing priority sector lending beyond the stipulations laid down.

Keywords: government policy and regulation, economic development, financial markets, institutions and growth

JEL Classification: G28, O16, O43, O53

Introduction

Franklin Roosevelt, the popular president of United States of America in 1932, referred to the American poor as the forgotten man at the bottom of the economic pyramid. Today the term 'bottom of the pyramid' refers to the global poor most of whom live in the developing countries. These large numbers of poor are required to be provided with much needed financial assistance in order to sail them out of their poverty conditions. Amartya Sen (2000) convincingly argued that poverty is not merely insufficient income, but rather the absence of wide range of capabilities, including security and ability to participate in economic and political systems. Joseph.E.Stiglitz opines that, if economic growth is not shared throughout society then development has failed. Accordingly, there is felt a need for policy support in channeling the financial resources towards the economic upliftment of resource poor in any developing economy.

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Inclusive Growth

Economic growth is a topical phenomenon in human history which was set in motion with the industrial revolution. Much of the development process can be understood by studying factors that impede the efficient and equitable functioning of markets. There is a large theoretical literature in development economics that looks at credit from a market failure perspective. The tale of economic underdevelopment is, more or less, a story of how unofficial, ingenious institutions replace the formal constructs that we are adapted to in developed economies. While the landlord lends to his tenant farmer accepting labor as collateral, but a formal credit market is missing and when the villagers insure each other against idiosyncratic shocks using their greater information and their ability to impose social sanctions, a formal insurance market is missing. Institutions as diverse as bonded labor, credit cooperatives, and extended families could be construed as response to market failure of some sort. A fundamental implication of misplaced markets is that inequality in the distribution of income or wealth plays a central role in many development problems (Ray, 1998).

Development economists and states have often been for a long time interested in the relationship between financial development and economic growth especially in the period which is known as the era of the Washington Consensus. A growing GDP is an evidence of a society getting its collective act together for progress. As its economy grows, a society becomes more strongly organised, more compactly interwoven. Growth is good, Sustained high growth is better and Sustained high growth with inclusiveness is best of all. Inclusive growth in the economy can only be achieved when all the weaker sections of the society including agriculture and small scale industries are nurtured and brought on par with other sections of the society in terms of economic development. Equitable growth is indeed an imperative for inclusive growth.

The major development challenge is to make the growth inclusive. Policies for inclusive growth are vital components of majority of government strategies for sustainable growth. Commission on Growth and Development (2008) notes that inclusiveness—a concept that encompasses equity, equality of opportunity, and protection in market and employment transitions – is an essential ingredient of any successful growth strategy. Three pillars of inclusive growth are; (i) Maximise economic opportunities (ii) Ensure economic well being and (iii) Ensure equal opportunities to economic opportunities (Ifzal, 2007). An inclusive growth strategy encompasses the key elements of an effective poverty reduction strategy and, more importantly, expands the development agenda. As a poverty reduction strategy, developing inclusive financial systems should be given priority, which is financially and socially sustainable (Bhandari, 2009). Indeed concept of Inclusive growth is millions of years old in the Indian Context. The ‘Shanti Mantra’ – a peace hymn –

from the ‘Kato Upanishad’ of the Hindu Scriptures, some three millennia ago runs like this: ‘Om Sahana Vavatu Sahanau Bhunaktu, Saha Viryam Karawavahai, Tejasvinavaditamastu, Ma Vidvishavahai, Om Shanti hi Shanti hi Shanti hi’ and translates to: ‘Together may we be protected, together may we be nourished, together may we work with great energy, may our journey together be brilliant and effective, may there be no bad feelings between us, Peace, Peace, Peace’. The well acceptable inclusive growth can be realised when there is commensurate financial development with a focus on inclusiveness.

Financial Development

If the 1950s, 60s and 70s were the ‘golden age of capitalism’ for the industrialized world, then in much part of the developing world the same period can be phrased as the ‘age of developmental state’ (Marglin and Schor, 1990; Wade, 1990). In many of the developing world, state was seen as general agent of development and state intervention in the area of policy and prescriptions for enabling faster economic development and consequent inclusive growth (Epstein and Grabel, 2007). Beginning with Ricardo and through Marx, Schumpeter, Gerschenkron and Rostow, various theories of growth have been propounded. The ideas of development economics (Krugman, 1995) were once regarded as revolutionary and important and commanded both great intellectual prestige and substantial real-world influence. In developing countries economic transformation is surely the most important and perhaps the most complex of all economic issues (Ray, 1998).

Since the groundbreaking contributions of King and Levine (1993a, b), economists have shown renewed interest in the finance–growth nexus. It is indeed irrefutable that considerable part of the differences in long run economic growth across countries can be elucidated by disparity in their financial development (King and Levine, 1993; Levine and Zervos, 1998, Demircuc-Kunt and Maksimovic (1998) and Rajan and Zingales, 1998). Beck, Demircuc-Kunt, Laeven and Levine (2006) use Rajan and Zingales (1998) approach, which provides supplementary evidence that financial development increasingly props up the growth of smaller firms which constitute largely the priority sector lending in the case of Indian Financial sector. Recent survey evidence suggests that access to finance has a direct nexus with faster rates of innovation and firm dynamism consistent with the cross-country finding that finance promotes growth through increase in productivity (Ayyagari, M., Demircuc-Kunt, A. and Maksimovic, V, 2007b, Levine, 1998, 1999). Further, it has also been revealed that financial development plays a significant role in moderating the impact of external shocks on the domestic economy (Beck, Lundberg, and Majnoni, 2006 and Raddatz, 2006).

Levine, (1998), (1999) and Beck, Demirguc-Kunt and Levine (2007) have noticed a positive effect of finance on poverty reduction. Economies with higher levels of financial development experience faster reduction of poverty. This has been explained by an extensive body of literature including Deininger and Squire (1998), Dollar and Kraay (2002), White and Anderson (2001), Ravallion (2001) and Bourguignon (2003). In an often cited cross-country study, Kraay (2004) proves that growth in average incomes explains 70 percent of the variation in poverty reduction (as measured by the headcount ratio) in the short run, and as much as 97 percent in the long run. Lopez and Servén (2004) suggest that for a given inequality intensity, the poorer the country is, the more vital is the growth component in explaining poverty reduction. To substantiate further, the recent endogenous growth literature, building on 'learning by doing' processes, assigns a special role to finance (Aghion and Hewitt, 1998 and 2005, Banerjee and Newman, 1993; Galor and Zeira, 1993; Aghion and Bolton, 1997).

Besides debate concerning the role of finance in economic development, economists have also debated the relative importance of bank-based and market-based financial systems for a long time (Goldsmith, 1969; Boot and Thakor, 1997; Allen and Gale, 2000; Demirguc-Kunt and Levine, 2001). Joseph Schumpeter argued in 1911 that banks play a pivotal role in economic development. According to this view, the banking sector alters the path of economic progress by affecting the allocation of savings and not necessarily by altering the saving rate. Largely, the Schumpeterian view of finance and development highlights the impact of banks on productivity growth (Schumpeter, 1934). Banking sector can wield a positive influence on the overall economy, and hence is of broad macroeconomic importance (Bonin and Wachtel, 1999, Jaffe and Levonian, 2001, Rajan and Zingales, 1998, Wachtel, 2001,).

It is established that better developed banks and markets are closely associated with faster growth (Levine, Loayza and Beck, 2000; Loayza and Ranciere (2002); Christopoulos and Tsionas, 2004). Improved functioning of banks can be able to boost resource allocation and hasten growth (Boyd and Prescott 1986; Greenwood and Jovanovic 1990; King and Levine 1993; Levine, R. and S. Zervous 1998). Correspondingly, by aiding risk management, improving the liquidity of assets available to savers, and by lowering trading costs; banks can enliven investment in potential economic activities (Obstfeld 1994; Bencivenga and Smith 1991; Greenwood and Smith 1997). Banks do exercise significant and causal impact on productivity growth, which feeds through to overall GDP growth. The long-run association between prioritised banking and both capital growth and private savings are more tenuous (Levine, Ross; Loayza, Norman; and Beck, Thorsten, 1999). It is also ascertained by some researchers that the size of the banking sector can be safely

considered a good predictor for future growth, especially when focusing on long term projects (Andrea Vaona, 2005).

Table 1: Global Experiences of Regulated Credit for Economic Development

Country	Schemes	Experience	Current Status
Brazil	Sectorally directed credit (quantity controls) combined with lower than market interest rates (price controls), or budgetary or off budget support, often funneled through publicly owned banks.	Directed credit failed to meet intended targets, with better-off farmers capturing much of the subsidies.	
China	Lending quotas for State-owned Banks and price control schemes.	Large NPLs, political biases, and difficulties in monitoring.	Experimenting with switchover to micro financing actively since 2000
India	A target of 40 per cent of net bank credit has been stipulated for lending to the priority sector by domestic commercial banks.	The priority sector lending is fraught with targeting problem, though asset quality has not been a major issue.	Continues
Indonesia	Special credit scheme (KUK) - Pakjan 90 and Pakmei 93.	Characterised by high defaults	The emphasis has gradually shifted to microfinance
Nepal	'Intensive Banking Programme (IBP)' based on the 'Area Development Approach' and provides credit to all the beneficiaries within a specific geographical area		Deprived sector lending is proposed to be continued.
Pakistan	Mandatory credit targets for agriculture since 1972.	Agricultural credit in volume terms has increased	Legal and regulatory systems have been put in place to provide an enabling environment
Philippines	Banks are required to allocate an amount equivalent to at least 25 per cent of their loanable funds for agricultural credit,		Carried out by government financial institutions (i.e. Land Bank of the Philippines, Development Bank of the Philippines, etc).

Source: Draft Technical Paper by the Internal Working Group on Priority Sector Lending, RBI, 2005

Even though finance prospers on market discipline and fails to contribute to development process effectively in the presence of interventionist policies, governments undoubtedly have an exceptionally vital role to play in promoting

well-functioning financial systems (Asli, 2008). The dynamic involvement of government thus makes certain the superior functioning of the banking sector, which sequentially has a growth enhancing effect (Arun and Turner, 2002c, Deniz, Desai and Gueorguiev, 1998, Gerschenkron, 1962, La Porta, Guiso et al., 2004a, b, 2006; Usai and Vannini, 2005; Jappelli et al., 2005). Governments play an important role in building effective and inclusive financial systems and policies to make finance work for development (Aslı Demirgüç-Kunt, 2008, La Porta et al. 1998). Directed credit programme involving loans on preferential terms and conditions to priority sectors was a major tool of development policy in both developed and developing countries in the 1960s, 1970s and mid-1980s. Japan and other East Asian countries have focused on directed credit programmes. Of course, a few countries like Nepal, Pakistan, and Philippines continue to prescribe directed credit requirements. A few economies in transition like Peoples Republic of China (PRC), Kyrgyz Republic, and Vietnam do not have directed credit requirements as such, but do have certain comparable programmes. In Korea, directed credit programmes were more extensive than in Japan and amounted to over 50 per cent of total lendable resources in the 1970s, though they fell to around 30 per cent of the total lendable resources of the financial system in the 1980s following the rise in the relative share of finance companies and other non-bank financial intermediaries. In China, policy-based lending amounted to about a third of total bank credit. A distinguishing feature of policy-based finance in Japan and Korea was the close degree of monitoring and supervision of the allocation and utilization of preferential funds. Both countries promoted close consultation, coordination and information exchange between the government and the private sector (Internal Working Group on Priority Sector Lending, (2005).

Indian Scenario

Indian economy is primarily agricultural based and agriculture continues to be a major sector in terms of its contribution to national income. The farmers constitute an important segment of rural India. Agriculture is a major sector of Indian economy as 67 percent of the working population is employed in it and almost 78 percent of the farmers are small and marginal farmers. The farmers in general and small and marginal farmers in particular, do not have capital or ability to invest in agriculture. Similarly, Small Scale Industries, Rural Cottage Industries, Tiny Industries, Small Business Enterprises, Professionals and Self Employed in rural areas, retail traders, education, housing, weaker sections and other sections needed and still need prioritized financial assistance in view of the apathy of the commercial banks in helping these sections of the society.

In order to achieve equitable growth in the economy there is need for continued focus on priority sector lending in India. Public policy in India has consistently conferred a pivotal role for bank lending in the process of economic development. Post independence and post nationalisation banking progress in India has received encomium in literature on the constructive role played by bank lending in the process of economic development. The system of directed credit programmes has clearly contributed to an expansion of credit in the directions that were considered necessary. According to World Bank (2006), the government of India's justifiable concern with the inclusiveness of economic growth can be addressed by focusing on expanding the regional scope of economic growth, expanding access to assets and thriving markets and expanding equity in the opportunities. In this background we notice that the twin objectives of the nationalization of banks were rapid branch expansion and the channeling of credit in tune with the main concerns of the five-year plans. To achieve these objectives, the newly nationalized banks received quantitative targets for the expansion of their branch network and also for the proportion of credit they had to extend to priority sector in the economy (Bhide, Prasad and Ghosh, 2001; Joshi and Little, 1997; 2003; Reddy, 2002b). Furtherance to the nationalization of banks, the priority sector lending target was raised to 40% (Arun and Turner, 2002a; Hanson, 2001; Ganesan, 2003; Kumbhakar and Sarkar, 2003). The rationale behind directed credit is mainly to viaduct the gap between private and social benefits, whilst high investment risk of the projects and problems of information asymmetry discourage lending to small and medium sized firms. Use of policy-based lending, in addition to other forms of industrial assistance (e.g. lower taxes, grants, etc.), is premised on the argument that the main constraint facing new or expanding enterprises is their limited access to external finance at reasonable terms and conditions (Internal Working Group on Priority Sector Lending, (2005). Directed credit programmes involving small subsidies overcome this constraint. The system of directed credit programmes has clearly contributed to an expansion of credit in the directions that were considered necessary (Narasihmam, 2002). Bell and Rousseau (2001) have explained that financial institutions in India have had an instrumental role in influencing the overall economic performance. Burgess and Pande (2003 and 2004) and Burgess, Pande and Wong (2004) have concluded that the directed bank lending (under which priority sector lending is regulated) has indeed helped in reducing poverty across Indian states.

Priority sector lending by commercial banks in India is monitored by Reserve Bank of India through periodical returns received from them. Performance of banks under this criterion is rigorously reviewed in the various fora set up under the Lead Bank Scheme (at State, District and Block levels). Directed lending in the Indian banking sector have been guided by the recommendations of various expert committees (Gupta Committee, Vyas Committee, Samal Committee and Working

Group (Chairman: C.S. Murthy) on Priority Sector Lending (2005). The guiding principle of the revised guidelines on lending to the priority sector has been to ensure adequate flow of bank credit to those sectors of the society/economy that impact large segments of the population and weaker sections, and to the sectors that are employment-intensive such as agriculture, and tiny and small enterprises.

The importance of this study lies in the fact that India being a socialist, democratic republic, it is imperative on the policies of the government to ensure equitable growth of all sections of the economy. Priority sector lending in a socialistic economy is very important as it directly affects the economic conditions of the resource poor. It is universally opined that the resource poor need financial assistance at reasonable costs and that too with uninterrupted pace. However, the economic liberalization policies have always tempted the financial institutions to look for more and more greener pastures of business ignoring the weaker sections of the society. It is essential for any economy to aim at inclusive growth involving each and every citizen in the economic development progression. It is in this context that a study has to be made to understand the importance of priority sector lending in ensuring the inclusive growth in the Indian context. Select macro-economic and financial indicators of Indian economy are presented here below in Table-2.

Table 2: Select Macro-Economic and Financial Indicators of Indian Economy

Indicators	1992-93	2008-09
1. Population (in mn)	872	1138
2. Per capita income*(in Rupees)	7698	33299
3. GDP (constant prices) (in Crores)	792150	4303654
5. Scheduled Commercial Banks	76	80
6. SCB branches	75821	64608
7. SCB Rural & Semi-urban branches	33025	36204
8.No. of ATMs	-NA-	43651
9. Bank assets (in Crores)	385778	52,41,330
10. SCB Gross Advances (in Crores)	151982	30,00,906
11. SCB Deposits (in Crores)	268572	40,63,203
12. SCB Net Profit (in Crores)	(-)4150	52,771
13. Priority sector lending(in Crores)	59097	1,68,506
14. SCB Loans A/Cs under SBLP(in 000s)	0.255	2831
15. SCB Loans O/S under SBLP (in Crores)	0.29	16,149

16. No. of RRBs (*after amalgamation)	196	86 *
17. RRBs Assets (in Crores)	9860	145824
18. RRB Deposits (in Crores)	6960	117984
19. RRB Advances (in Crores)	4474	69030
20. RRBs Profit (in Crores)	(-) 311	1830
21. No. of Local Area Banks (LABs)	-	4
22. LAB Assets	-	786.6
23. No. of Cooperatives		97782
24. No. of Kisan Credit Cards Issued (Numbers in million)	-	84.6
25. Financial Assistance Sanctioned and Disbursed by Financial Institutions (in Crores)	-	88,973
26. No. of No-frill accounts	-	33,024,761

Source: Reserve Bank of India Publications

On a perusal of the available literature on directed lending, it is felt that in the backdrop of the available research findings it is time to analyse the impact of priority sector lending in the process of economic development. Accordingly, it is attempted in this study to analyse the relevance of priority sector lending in the Indian context for the period involving both the pre and post liberalisation period.

Analysis

In view of the aforesaid importance of Priority Sector Lending in the Indian context, this study has the following objective:

To understand the impact of Priority Sector lending by banks on inclusive growth in India and establish the relationship of Priority Sector lending on indicators of inclusive growth such as; Credit to GDP, GDP, Capital Formation in Household Sector, Total Capital Formation, Total Food grains Production, Employment in SSI sector and Output by SSI sector.

On the basis of the above mentioned objective, the following hypothesis was developed to be tested in the present study: The null hypothesis for the above test H0: Coefficient of the parameter is not different from zero that is the parameters for the test do not have the significant impact on the poverty level and the alternative hypothesis H1: Coefficient of the parameter is significantly different from zero that is

the parameters have the significant impact on the poverty. Significance level for the study is set at 5%.

The required data for the analysis is obtained largely from the most reliable and official sources such as Reserve Bank of India website, NABARD website, India Development Report 2008 and other related sources. Economic Reforms in Indian economy were initiated in the year 1991-92. As such, to cover equal number of years of priority sector lending and inclusive growth during pre and post-Liberalisation period, data for the period from 1974-75 to 2007-08 has been analysed for understanding the trends. For the purpose of analysis the most popular statistical measure Multiple Regression (OLS) Analysis is used (Andrea Vaona, 2005, Andrea Vaona and Roberto Patuelli, 2008 have also used the same kind of analysis for similar studies).

The objective of this section of the paper is to identify the determinants of Inclusive Growth which can be captured in Rural Poverty (RU_POV) (measured in percentage against that of the total population in rural areas and these figures are provided by the Census of India data) in India and ascertain the impact of Priority Sector Lending (PSL) on rural poverty in India. Priority Sector Lending in the Indian context refers to the bank credit under the directed lending towards the private firms and individuals which is an important parameter that determines the measure of development that can significantly contribute to inclusive growth (Vaona, 2005). Domestic Savings (SAV) (measured in Rupees in Crores) is included as a determinant in order to account for the argument that savings propels economic activity in the system at large and helps in inclusive growth process (Beck, Levine and Loayza 2000). Rural Employment is one of the significant measures of economic development and consequently of inclusive growth. A greater level of rural employment can be taken as evidence of greater economic development (Cole Shawn, 2007). In recognition of this argument, Employment in Rural Primary sector (EMP_RP) (expressed in million numbers) is included as one of determinants to study their impact on inclusive growth. Agricultural Production is another important determinant that affects the inclusive growth process in rural India. As a large population of weaker sections of the society still depends to a large extent on agriculture, Agricultural Production (AGRI_PRO) (expressed in Kilograms/hectare) determines their upward movement in the income ladder (Vaona, 2005 also considered production as an important variable in a similar study). Accordingly, agricultural production is also considered as a determinant in the analysis. There is also an indisputable argument that overall credit has profound impact on inclusive growth process (Andrea Vaona, 2005). In view of this, Credit to Gross Domestic Product (CRED_GDP) (measured as a ratio in percentage to GDP) is included as a determinant. If there is an increase in Per Capita Income (PCI) (measured as per capita NNP at factor cost expressed in Crores in Rupees) there certainly will be an

increase in inclusive growth process. As such, Per Capita Income (is used as a determinant in a similar analysis by Andrea Vaona and Roberto Patuelli, 2008, Srinivasan 1994, Streeten 1994, Sen 1992 and Sugden 1993) is commonly accepted measure of standard of living of people and consequently is a major factor that enhances inclusive growth and hence it is included in the analysis.

The regression model can be:

$$Y = \alpha + \beta_1 X_1 + \dots + \beta_n X_n + \mu \quad (1)$$

Accordingly, rural poverty can be better explained and estimated with the following version of equation:

$$RU_POV = f(PSL, SAV, EMP_RP, AGRI_PRO, CRED_GDP, PCI) + \mu \quad (2)$$

In order to control for other factors associated with economic growth not linked to financial development, the regression results are presented by using a simple conditioning information set, including the constant, the logarithm of all explanatory variables. Due to potential nonlinearities, the natural logarithms of the regressors are considered (Levine, Loazya and Beck, 2000).

Accordingly, when we log-transform this model (also called a log-log, double-log) we obtain:

$$\text{Log}(RU_POV) = \alpha + \log(PSL, SAV, EMP_RP, AGRI_PRO, CRED_GDP, PCI) + \mu \quad (3)$$

‘ α ’ represents the ‘Y intercept’, β_1, \dots, β_n represent the respective regression coefficients for explanatory variables X_1, \dots, X_n and ‘ μ ’ represents the error term. Where, ‘Y’ represents the ‘RU_POV’, i.e, Rural Poverty and ‘ X_1 ’, ‘ X_2 ’, ..., ‘ X_{14} ’ represent the predictor variables and ‘ β_1 ’, ‘ β_2 ’, ..., ‘ β_n ’ represent the partial regression coefficients of ‘PSL’ i.e, ‘Priority Sector Lending’, ‘SAV’-Savings, ‘EMP_RP’-Employment in Rural Primary sector, ‘AGRI_PRO’-Agricultural production, ‘CRED_GDP’-Credit to Gross Domestic Product and ‘PCI’-Per Capita Income respectively. ‘ μ ’ represents the ‘error term’. The results of analysis are presented in Table 3 for the period from the year 1977 to 2007. Inferring from the results of this analysis, it can be concluded that Priority sector lending has significant impact on rural poverty.

Table 3: Results of regression analysis for understanding the impact of determinants of inclusive growth

Variable	Coefficient	Prob.
Constant	-2.213583	0.7656
LOG(PSL)	0.310230	0.0059*
LOG(SAV)	-0.804166	0.0001*
LOG(EMP_RP)	-0.502652	0.3759
LOG(AGRI_PRO)	-0.286433	0.3869
LOG(CRED_GDP)	-0.831765	0.0016*
LOG(PCI)	1.803471	0.0016*
R-squared	0.948572	
Adjusted R-squared	0.935715	
Durbin-Watson stat	1.923164	
F-statistic	73.77883	
Prob(F-statistic)	0.000000	
Dependent Variable:	LOG(RU_POV)	

Note: * at 1% significance level * at 5% significance level

Source: Outcome of analysis of this study

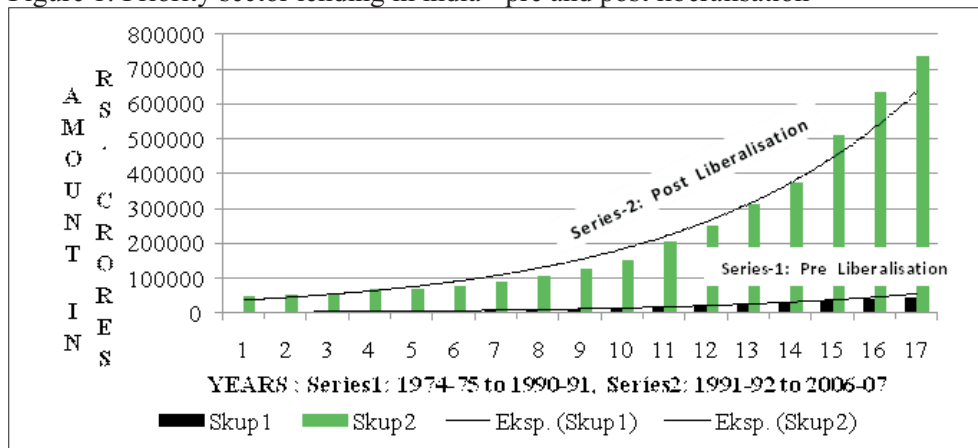
Graphical presentation of the trend of priority sector lending in the pre liberalisation period from 1974-75 to 1990-91 and post liberalisation period from 1991-92 to 2006-07 is illustrated in Figure-1. It is clearly evident from the figure that priority sector lending has taken a gradually upward moving curve indicating a steady rise in the post liberalisation era.

Table 4: Nature and strength of the impact of various determinants on inclusive growth

Explanatory Variable	Correlation Trend
Priority Sector Lending(PSL)	Positive and highly significant
Domestic Savings (SAV)	Negative and highly Significant
Employment in Rural Primary sector (EMP_RP)	Negative and insignificant
Agricultural Production (AGRI_PRO)	Negative and insignificant
Credit to Gross Domestic Product (CRED_GDP)	Negative and highly Significant
Per Capita Income (PCI)	Positive and highly Significant

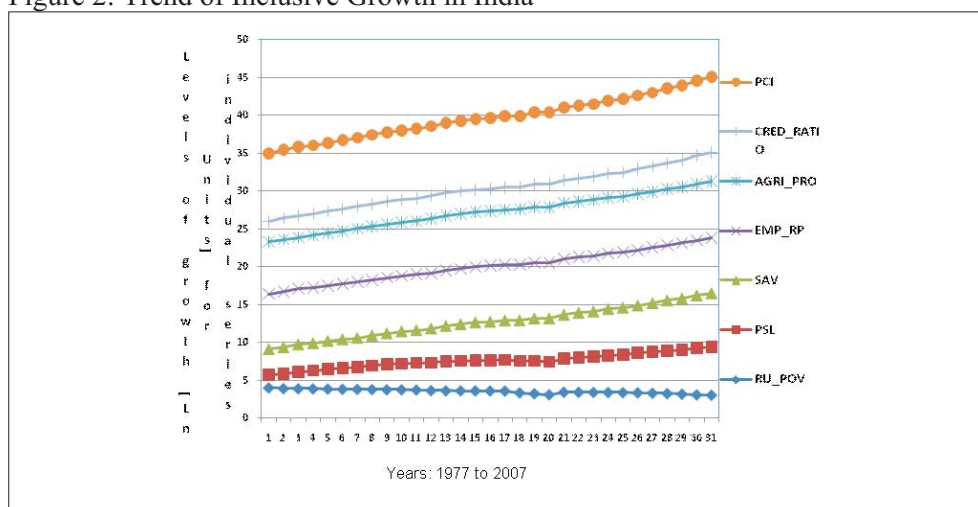
Source: Outcome of analysis of this study

Figure 1: Priority sector lending in india - pre and post liberalisation



Source: Outcome of analysis of this study

Figure 2: Trend of Inclusive Growth in India



Source: Outcome of analysis of this study

Further, the Nature and strength of the impact of the various determinants on Inclusive growth are captured in Table-4 here below.

A graphical presentation of the trend of the inclusive growth in India is presented in Figure 2. It is orchestrated by the rhythmic forward movement trends of the above discussed determinants during the study period. Rural Poverty is on a declining trend more pronouncedly during the post liberalisation period.

Findings of the Study

The study found that Priority Sector Lending has a very high significant impact on inclusive growth, which is in line with the findings of Kraay (2004) and Beck, et al (2007). Domestic Savings (in line with the conclusions of Levine, Ross; Loayza, Norman; and Beck, Thorsten, 1999), Credit to Gross Domestic Product (as established by Ayyagari, M., Demirgüç-Kunt, A. and Maksimovic, V, 2007b, Narasimham, 2002, Obstfeld 1994; Bencivenga and Smith 1991; Greenwood and Smith 1997) and Per Capita Income (as stated by Levine, 1998, 1999) are found to have significant impact on reducing rural poverty in India. The model developed in the study explains the trend of rural poverty (Lopez and Servén, 2004) to the extent of 93.5 percent involving the important determinants such as Priority Sector Lending (Rajan and Zingales 1998), Savings, Employment in Rural Primary sector, Agricultural Production (Andrea Vaona, 2005), Credit to Gross Domestic Product (Andrea Vaona, 2005) and Per Capita Income (Andrea Vaona and Roberto Patuelli, 2008, Srinivasan 1994, Streeten 1994, Sen 1992 and Sugden 1993). Further, it is also demonstrated (Figure-2) that financial sector reforms have indeed had a positive impact on reduction of rural poverty.

Policy Choices and Conclusion

Undoubtedly, Priority Sector Lending in India has been largely influenced by directed lending approach of the Government policy in India. As such, there is a strong need to strengthen this policy approach for financing the priority sector. Further, in view of the findings I do not appreciate the measure of the government in allowing the (failing) banks in meeting the Priority sector lending obligation to park their shortfall in the Rural Infrastructure Development Fund as this has resulted in the gradual decrease in the priority sector lending when compared to total bank lending. Priority sector lending over a period of years in Indian banking has had clearly established a positive impact on inclusive growth. In view of the strong relationship between priority sector lending and inclusive growth, it is imperative on the policy makers in general and the governments in particular to make efforts to motivate the banks and financial institutions in increasing priority sector lending beyond the stipulations laid down by Reserve Bank of India. The banks in India are required to expand their efforts exponentially to reach out to the priority sector in providing fair and equitable financial assistance for achieving inclusive growth.

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